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IN THE

Supreme Court of the United States

OCTOBER TERM, 1953

No. 278

JOSEPH H. HIRSHHORN,

Petitioner,

vs.

MINE SAFETY APPLIANCES COMPANY, ET AL.,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

PETITIONER'S REPLY BRIEF

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Statement

The gist of Mine Safety's justification of its alleged employment of Jackson is that in September, 1936, he was out of work for Catalyst. At pages 3 and 4 of respondents' brief it is asserted that Mine Safety engaged Jackson to work on the rebreather project, which, however, at that time was but an unsolved problem, because Catalyst had no other work for him to do. This is flatly contradicted by Mine Safety's own records of the subsidiary payrolls, which show that between January 1, 1936 and

December 31, 1937, 65% of Jackson's salary, advanced by Mine Safety, was charged to Catalyst (R. 194a). Mine Safety, therefore, did not employ a man out of work; without asking leave, it "borrowed", *i. e.*, helped itself to the services of Jackson from Catalyst, whose covenanted right to his inventions remained intact. There is no evidence of Catalyst "lending" Jackson to Mine Safety, as stated on page 8 of respondents' brief.

Jackson's general and exclusive employment by Catalyst was never changed into a "dual employment."; that is a figment contrived by defendants perforce their manipulations of the payrolls of Jackson and Bennett, the research scientists of Carbon-Catalyst, whose minority stockholders and boards of directors knew nothing about the "adjustment" (R. 21a, 22a, 25a, 43a, 44a, 58a-60a). Dual employment connotes agreement between general and special or temporary employer, a bargain, much less an arm's length bargain, of which here there was no semblance. And when Jackson was requisitioned on the rebreather, his work in the Carbon-Catalyst laboratory (R. 132a) which resulted in his rebreather inventions, was certainly connected with the purposes and actual business of Catalyst, *viz.*, to develop chemical and mineral products and apparatus in connection therewith (R. 86a, 87a). It was chemical and metal experimentation.

At page 9 of their brief respondents also assert that Jackson's work for Mine Safety was disclosed to and discussed with Catalyst stockholders. The reference (R. 60a) is to Deike's testimony; but that is of no value, because it refers to the transfer of Carbon and Catalyst to Pittsburgh, and was corrected by Deike himself when he emphatically stated in connection with Jackson's reemployment by Catalyst in April 1935, that as part of their employment by Carbon and Catalyst both Jackson and Bennett were expected to cooperate with Mine Safety (R. 46a, 47a). On May 31, 1935, Deike as President signed

up Jackson to transfer his inventions to Catalyst, with no mention of Mine Safety (R. 175a, 176a).

But the overshadowing and far-reaching error and wrong and resulting conflict from the decisions below, which should be reviewed in the general interest of justice and corporate administration, is that while the courts below have paid lip service to the fiduciary principle, they have utterly failed to apply it to master-servant relations where dominant and subject corporate interests are involved. They and respondents maintain that dealings between parent and subsidiary corporations do not require for validity the approval or ratification of minority stockholders; but that is not the question. Here there was no dealing between parent and subsidiary. It was the unilateral act of mine safety, the parent. The subsidiary, in so far as the minority were concerned, had nothing to do with it. The real question is, where the majority have the minority at their mercy, may they appropriate to themselves essential or main property or property rights of the subsidiary without the consent or acquiescence of the minority? (R. 145a). The answer as applied to this kind of case is that they cannot; otherwise, what has been written and adjudicated of trust relations is a mockery (*Allied Chemical & Dye Corp.* v. *Steel & Tube Co.*, 14 Del. Ch. 1, 12 Atl. 486).

ARGUMENT

I.

Application of the Fiduciary Principle.

This refers directly to petitioner's second specification of error (Brief, pp. 12-13).

On the present record it must be acknowledged that the management (Mine Safety) (R. 347a) was and is trustee of the corporate assets of Catalyst, notably, Jackson's productivity and, under the assignment, his products, for the beneficiaries, *viz.*, the minority Catalyst stockholders.

The domination of Mine Safety was so absolute that no other rule could apply. This Court has said in *Pepper* v. *Litton*, 308 U. S. 295, 306, that the powers of a dominant stockholder or group of stockholders are powers in trust; also that their dealings, contracts or engagements with the subject corporation or interest must carry the earmarks of an arm's length bargain. There was no bargain or dealing, no contract or engagement between Mine Safety and Catalyst; Jackson's services and inventions were simply appropriated, and part of his salary charged by defendants to Mine Safety. As shown in the foregoing statement, this was done without any notice to or knowledge, much less consent, of the Catalyst minority. Dr. Frazer's protest of June 25, 1942, emphasized that Mine Safety had deprived the subsidiaries of profits from work which clearly came within their field (R. 190a, fol. 570). In such a situation the liability of strict trusteeship should have been imposed on Mine Safety. *Pepper* v. *Litton* (*supra*) means nothing less. At page 311 it defines the elements and restrictions: the fiduciary cannot serve itself first and its *cestui* second; it cannot manipulate the affairs of the subject corporation to their detriment and in disregard of the standards of common decency and honesty; it cannot use the corporate entity to violate the ancient precept against serving two masters; it cannot use its inside information and strategic position for its own preferment; it cannot violate rules of fair play by doing indirectly through the subject corporation what it could not do directly; it cannot use its power for its own advantage, no matter how meticulous it is to satisfy technical requirements.

In *Twin Lick Oil Co.* v. *Marbury*, 91 U. S. 587, 590:

> "If he should be a sole director or one of a smaller number, vested with certain powers, this obligation would be still stronger and his acts subject to more severe scrutiny and their validity determined by more rigid principles of morality and freedom from motives of selfishness."

The true principle, therefore, that should have been applied by the courts below to the acts of Mine Safety with respect to Jackson and his inventions, was liability commensurate with the absolute power which it wielded, as absolute as that of any trustee under a testament or other formal instrument. The greater the power the more exacting the fiduciary obligation and liability. This is at the basis of the local law of Pennsylvania, Delaware and Maryland in the decisions cited in petitioner's brief (pp. 16-18). In such a case the "great rule of law" which invalidates self-dealing, self-serving acts of a trustee with the subject matter of his trust, still applies. Despite the assertion of respondents to the contrary, *Munson* v. *S. G. & C. R. R. Co.*, 103 N. Y. 53, survives in its full sweep where control is absolute. Learned Hand, C. J., in *Dabney* v. *Chase National Bank of N. Y.*, 196 Fed. (2d) 668, 670. It depends on whether the subject interest has had an opportunity, through director representation or otherwise, to assert itself and challenge an appropriation by the controlling interest; if it has not, the dominant party must be judged on the basis of strict trusteeship, the obligations and disabilities of which are set out in Sections 170, 205 and 206 of the Restatement of the Law of Trusts. There must be a disclosure to the beneficiary of all material facts, section 170(2); the trustee may not profit at the beneficiary's expense without the latter's consent, section 170(2)(a); personal interest may not conflict with duty as trustee, section 170(2)(b); a trustee may not dispose of the trust res to itself while acting as corporate fiduciary, section 170 (2)(d); or to another corporation where the directors are the same or nearly the same, section 170(2)(d); or use the trust property for its own purposes, section 170(2)(e); or compete with the interests of the beneficiary, section 170(2)(o); and acquisition without the consent of the beneficiary may be set aside or call for accounting of profits, section 170(2)(u). Violation of these obligations and restrictions or any of them incurs the liabilities imposed by sections 205 and 206.

If Jackson had been assigned to solve the rebreather problem in the laboratory of Carbon-Catalyst, where it was solved, and his salary while so engaged was charged 100% to Catalyst, certainly the appropriation of his rebreather inventions by Mine Safety without the consent of the Catalyst minority as beneficiaries of the trust, would have been a bald violation of the above principles. The device of charging part of his salary to Mine Safety while Jackson was so engaged was no less so, and constituted no consideration for appropriating his productivity, to which Catalyst was entitled. It was a violation without the consent of the Catalyst minority, on suitable terms of return to Catalyst for the productivity. A bargain was indispensable. There was no bargain.

The Court of Appeals has ruled that the part payment of Jackson's salary and appropriation of his rebreather inventions, was an unimportant factor in these intercorporate activities, and that to contend that minority consent was required for their validation is an absurdity (R. 396). On the contrary, it was an all-important factor, because it tampered with the contract of employment of Jackson by Catalyst, and diverted the property in his future inventions, which had been assigned to that subsidiary, in the inventions which fell squarely within the charter purposes and varied activities of Catalyst (R. 86a, 87a, 177a, 178a, 163a).

In this setting, findings of good faith and fair dealing are immaterial; defendants kept faith and dealt only with themselves, not with Catalyst.

The fiduciary theory enunciated in *Pepper* v. *Litton* (*supra*), and universally held, and defined in the Restatement of the Law of Trusts, leaves no doubt that in the present case the crucial and controlling fact is that defendants' appropriation of Catalyst's corporate property was inconsistent with their fiduciary obligations to the

Catalyst minority stockholders who, having given no consent thereto, are entitled to restitution and an accounting for the unlawful appropriation.

The case is novel in its facts and implications, no precedent has been found directly pertinent to them, and the decisions of the courts below are so erroneous that in the interests of justice they warrant review and reversal by this Court.

Dated, September 21, 1953.

Respectfully submitted,

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